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IN THE

Supreme Court of the United States

October Term, 1994

CITIZENS BANK OF MARYLAND,

Petitioner,

v.

DAVID STRUMPF,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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QUESTION PRESENTED FOR REVIEW

Whether a bank creditor may refuse a bankrupt depositor's request to withdraw funds pending determination by the bankruptcy court of the bank's setoff rights, without violating the bankruptcy stay under 11 U.S.C. § 362(a).

TABLE OF CONTENTS

QUESTION PRESENTED FOR REVIEW i

TABLE OF CONTENTS. ii

TABLE OF AUTHORITIES. v

OPINIONS BELOW 2

JURISDICTION 2

STATUTORY PROVISIONS INVOLVED 3

STATEMENT OF THE CASE 4

REASONS FOR GRANTING THE PETITION . . . 8

I. THIS CASE PROVIDES THE COURT WITH THE OPPORTUNITY TO RESOLVE WIDESPREAD CONFLICT AMONG LOWER COURTS CONCERNING EXERCISE OF THE RIGHT OF SETOFF IN BANKRUPTCY 8

A. The Circuit Courts Of Appeals Are Divided On The Effect Of A Creditor's Exercise Of Its Rights Under § 542 Of The Bankruptcy Code 10

B. The District Courts And Bankruptcy Courts Are Also Divided On The Permissibility Of An Administrative Hold Or Freeze 18

II. THE LOWER COURT'S RULING HAS SEVERAL SERIOUS NEGATIVE PRACTICAL IMPLICATIONS 23

III. A BANK CREDITOR SHOULD NOT BE REQUIRED TO DISBURSE FUNDS FROM AN ACCOUNT OF ITS DEBTOR, PARTICULARLY WHERE THE CREDITOR MOVES PROMPTLY FOR AUTHORIZATION TO EXERCISE ITS SETOFF RIGHTS 26

A. The Lower Court's Opinion Disturbs The Statutory Balance Between A Creditor's Right Of Setoff And A Debtor's Need To Preserve And Use Accounts 26

B. The Fourth Circuit's Opinion Reflects A Misunderstanding Of The Relationship Between The Depositor And The Bank 33

C. The Court's Opinion Ignores Settled Law That The Right Of Setoff Must Be Respected, And Incorrectly Suggests That § 362(a)(7) Was Intended By Congress To Defeat The Right Of Setoff 35

D. The Court's Decision Incorrectly Equates A Setoff With A Bank's Temporary Refusal To Comply With A Debtor's Demand To Withdraw Funds 39

CONCLUSION 43

TABLE OF AUTHORITIES

CASES

Air Atlanta, Inc. v. Nat'l Bank of Georgia, Inc., 81 B.R. 724 (N.D. Ga. 1987) 19

Baker v. Nat'l City Bank of Cleveland, 511 F.2d 1016 (6th Cir. 1975) 40, 41, 42

Citizens Bank of Maryland v. Strumpf, 37 F.3d 155 (4th Cir. 1994) . . . . . passim

Citizens Bank of Maryland v. Strumpf, 138 B.R. 792 (D. Md. 1992) 2, 7

Cusanno v. Fidelity Bank, 29 B.R. 810 (E.D. Pa. 1983), vacated without opinion, 734 F.2d 3 (3rd Cir. 1984) 19

Dawson Chemical Co. v. Rohn & Haas, Co., 448 U.S. 176 (1980) 22

Gordon, Feinblatt, Rothman, Hoffberger & Hollander v. Gerhold, 608 A.2d 1194 (Md. App. 1992) 34

In re Air Atlanta, 74 B.R. 426 (Bankr. N.D. Ga. 1987), aff'd, 81 B.R. 724 (N.D. Ga. 1987) 20

In re American Sunlake Ltd. Partnership, 109 B.R. 727 (Bankr. W.D. Mich. 1989) 37

In re Bass Mechanical Contractors, Inc., 84 B.R. 1009 (Bankr. W.D. Ark. 1988) 31

In re Briggs, 143 B.R. 438 (Bankr. E.D. Mich. 1992) 20

In re Carpenter, 14 B.R. 405 (Bankr. M.D. Tenn. 1981) 21, 41

In re Cascade Roads, Inc., 34 F.3d 756 (9th Cir. 1994) 37

In re Crispell, 73 B.R. 375 (Bankr. E.D. Mo. 1987) 20

In re Cusanno, 17 B.R. 879 (Bankr. E.D. Pa. 1982), aff'd, 29 B.R. 810 (E.D. Pa. 1983), vacated without opinion, 734 F.2d 3 (3rd Cir. 1984) 21

In re Davis, 889 F.2d 658 (5th Cir. 1989), cert. denied sub nom., Campbell v. United States, 495 U.S. 933 (1990) 16, 17

In re De Laurentiis Entertainment Group, Inc., 963 F.2d 1269 (9th Cir. 1992), cert. denied, ___ U.S. ___, 113 S. Ct. 330, 121 L. Ed. 2d 249 (1992) 36

In re Edgins, 36 B.R. 480 (Bankr. 9th Cir. 1984). . . . . passim

In re Executive Assocs. Inc., 24 B.R. 171 (Bankr. S.D. Tex. 1982) . 21

In re Hoffman, 51 B.R. 42 (Bankr. W.D. Ark. 1985) 20

In re LHG Resources, Inc., 34 B.R. 202 (Bankr. W.D. Tex. 1983) 21

In re Lough, 163 B.R. 586 (Bankr. D. Idaho 1994) 20

In re Moreira, 173 B.R. 965 (Bankr. D. Mass. 1994) 20, 25

In re New York City Shoes, Inc., 78 B.R. 426 (Bankr. E.D. Pa. 1987) . 19

In re Patterson, 967 F.2d 505 (11th Cir. 1992) 13, 14, 15, 25

In re Pimental, 142 B.R. 26 (Bankr. D.R.I. 1992) 20

In re R.H. Williams, 61 B.R. 567 (Bankr. N.D. Tex. 1986) 20

In re Rio, 55 B.R. 814 (Bankr. M.D. Ala. 1985), rev'd, 82 B.R. 138 (M.D. Ala. 1986) 21

In re Saugus Gen. Hosp., Inc., 698 F.2d 42 (1st Cir. 1983) 41

Keller v. Fredericktown Sav. Inst., 66 A.2d 924 (Md. 1949) 34

Kenney's Franchise Corp. v. Cent. Fidelity Bank, N.A., 22 B.R. 747 (W.D. Va. 1982) 19

Rio v. Army Aviation Center Fed. Credit Union, 82 B.R. 138 (M.D. Ala. 1986) 19

Small Business Admin. v. Reinhardt, 887 F.2d 165 (8th Cir. 1989) 12

Sousa v. Bank of Newport, 170 B.R. 492 (D.R.I. 1994) 19

Stann v. Mid. Am. Credit Union, 39 B.R. 246 (D. Kan. 1984) 19

Taylor v. Equitable Trust Co., 304 A.2d 838 (Md. 1973) 34

United States v. Central Bank of Denver, 843 F.2d 1300 (10th Cir. 1988) 41

United States v. Norton, 717 F.2d 767 (3rd Cir. 1983) 12

United States v. Reynolds, 764 F.2d 1004 (4th Cir. 1985) . . . 12

STATUTES

11 U.S.C. § 362(a) . . . . . i, 36

11 U.S.C. § 362(a)(3) 13

11 U.S.C. § 362(a)(7) . . . . . passim

11 U.S.C. § 362(d) 5

11 U.S.C. § 362(e) 26

11 U.S.C. § 363 31

11 U.S.C. § 363(a). 3, 27, 28

11 U.S.C. § 363(c)(2) 28

11 U.S.C. § 502(b) 16

11 U.S.C. § 506 14

11 U.S.C. § 506(a) . . . . . passim

11 U.S.C. § 542 18

11 U.S.C. § 542(b) . . . . . passim

11 U.S.C. § 544 24

11 U.S.C. § 545 24

11 U.S.C. § 547 24

11 U.S.C. § 548 24

11 U.S.C. § 550 24

11 U.S.C. § 553 . . . . . passim

11 U.S.C. § 553(a) 32

28 U.S.C. § 1254(1) 3

28 U.S.C. § 1334(a) 4

Md. Comm. Law I Code Ann. § 4-303 (1992 Repl. vol.) 40

MISCELLANEOUS

B. Weintraub & A. Resnick, Freezing the Debtor's Account: A Banker's Dilemma Under The Bankruptcy Code, 100 Banking L.J. 316, 324 (1983) 32

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Citizens Bank of Maryland respectfully petitions for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit is reported at 37 F.3d 155 (4th Cir. 1994) and appears as Appendix A to this Petition.

The decision of the United States District Court for the District of Maryland is reported at 138 B.R. 792 (D. Md. 1992) and appears as Appendix B to this Petition.

The ruling of the United States Bankruptcy Court for the District of Maryland is not reported. A copy of the bankruptcy court's Order appears as Appendix C to this Petition.

JURISDICTION

The United States Court of Appeals for the Fourth Circuit entered its judgment on October 13, 1994. The court

of appeals entered an order denying Citizens' Motion for Rehearing or, in the Alternative, Suggestion of Rehearing In Banc on November 8, 1994. A copy of this Order is attached as Appendix D. Citizens files this Petition for Writ of Certiorari within ninety (90) days of that date. Citizens invokes the jurisdiction of this Court under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

This case principally involves consideration of five sections of the United States Bankruptcy Code, 11 U.S.C. §§ 101 et seq.[1] They are 11 U.S.C. § 362(a)(7), 11 U.S.C. § 363(a), 11 U.S.C. § 506(a), 11 U.S.C. § 542(b) and

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[1] The United States Bankruptcy Code is hereafter sometimes referred to as the "Bankruptcy Code."

11 U.S.C. § 553. The text of each of these sections is set forth in Appendix E to this Petition. None of the provisions of the Bankruptcy Code at issue in this case has been amended by the Bankruptcy Reform Act of 1994, enacted on October 22, 1994, in a manner material to the outcome of this case.

STATEMENT OF THE CASE

On January 25, 1991, David Strumpf ("Strumpf" or the "Debtor") filed a bankruptcy petition in the United States Bankruptcy Court for the District of Maryland seeking relief under Chapter 13 of the Bankruptcy Code. The bankruptcy court had jurisdiction under 28 U.S.C. § 1334(a).

At the time the bankruptcy petition was filed, Strumpf had a demand deposit account with a balance of $11,279.86 at

Citizens Bank of Maryland ("Citizens"),[2] and owed Citizens the sum of $3,250.48 in connection with a consumer loan which was in default.

On October 7, 1991, Citizens filed in the bankruptcy court a motion for relief from the automatic stay, pursuant to 11 U.S.C. § 362(d), to permit Citizens to exercise its right to set off Strumpf's debt to Citizens against funds held on deposit and due to Strumpf. Citizens simultaneously placed an "administrative hold" on $3,500 in the Strumpf account. On October 9, 1991, Strumpf filed a motion to hold Citizens in contempt for violation of the automatic stay.

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[2] Pursuant to Supreme Court Rule 29.1, Citizens discloses that Citizens Bank of Maryland is a wholly owned subsidiary of Citizens Bancorp. Citizens Bank of Maryland has no subsidiaries, other than wholly owned subsidiaries.

On November 7, 1991, the bankruptcy court held a hearing on Citizens' motion for relief from the automatic stay, at the conclusion of which the bankruptcy court reserved its ruling on the merits. On November 13, 1991, the bankruptcy court held a hearing on Strumpf's motion to hold Citizens in contempt, and granted the motion. The bankruptcy court held Citizens in contempt for violation of the automatic stay and awarded Strumpf attorneys' fees of $500.00, punitive damages of $375.00 and nominal damages of $25.00.

Ironically, the bankruptcy court subsequently granted Citizens' motion for relief from the automatic stay on December 2, 1991. By that time, however, Citizens was unable to effectuate a setoff, because Strumpf had withdrawn all

of the funds from his account after Citizens lifted the administrative hold in response to the bankruptcy court's November 13, 1991 ruling.

Citizens appealed the decision of the bankruptcy court to the United States District Court of Maryland (the Honorable John R. Hargrove). The district court reversed the bankruptcy court, holding that the imposition of an administrative hold on Strumpf's account did not violate the automatic stay, where Citizens moved immediately for an order seeking authority to exercise its setoff rights. See Citizens Bank of Maryland v. Strumpf, 138 B.R. 792, 794 (D. Md. 1992).

Strumpf then appealed to the United States Court of Appeals for the Fourth Circuit, which reversed the district court's ruling and remanded the case for

reinstatement of the bankruptcy court's Order. See Citizens Bank of Maryland v. Strumpf, 37 F.3d 155, 159 (4th Cir. 1994). The opinion of the court of appeals construed the administrative hold as "tantamount" to a setoff. The court further reasoned that the brief length of time between a creditor's imposition of an administrative hold and such creditor's request for permission to exercise its right of setoff had no bearing on whether the creditor violates the automatic stay. Id. at 158-59.

REASONS FOR GRANTING THE PETITION

I. THIS CASE PROVIDES THE COURT WITH THE OPPORTUNITY TO RESOLVE WIDESPREAD CONFLICT AMONG LOWER COURTS CONCERNING EXERCISE OF THE RIGHT OF SETOFF IN BANKRUPTCY.

Whether a creditor with a right of setoff may refuse a bankrupt's request to pay money due to the debtor otherwise

subject to setoff, pending the bankruptcy court's determination of the creditor's setoff rights, is one of the most fundamental unresolved issues of insolvency law. During the sixteen years since the enactment of the Bankruptcy Reform Act of 1978, confusion and division on this issue have developed unabated. This case presents the Court with an opportunity to return the law governing setoffs in bankruptcy cases to the carefully balanced statutory framework established by Congress in the Bankruptcy Code. By reviewing the decision below, this Court will prevent further confusion, among creditors and debtors alike, with regard to the proper disposition of funds held in a bank account which are subject to a creditor's right of setoff and which are treated as

the bank's collateral under § 506(a) of the Bankruptcy Code.

A. The Circuit Courts Of Appeals Are Divided On The Effect Of A Creditor's Exercise Of Its Rights Under § 542 Of The Bankruptcy Code.

In this case, Citizens sought permission from the bankruptcy court to exercise its right of setoff against Strumpf's deposit account, to the extent of Strumpf's debt to Citizens. Citizens' right of setoff is recognized expressly in § 553 of the Bankruptcy Code. To preserve that right of setoff, Citizens refused to honor Strumpf's demand to withdraw funds from his deposit account. Citizens' declination to pay money to the Debtor to the extent of the Debtor's defaulted loan to Citizens is authorized by § 542(b) of the Bankruptcy Code. To maintain the status quo and prevent

withdrawal of the funds while it sought relief from the automatic stay to exercise its setoff rights, Citizens placed an "administrative hold" on Strumpf's account.

The Fourth Circuit couched the issue as one of "first impression" among the circuit courts of appeals. In the narrow sense of the issue of the appropriateness of the use of an "administrative hold" by a commercial bank, that characterization is correct. Viewed in a more appropriate broader context, however, the administrative hold at issue in this case is nothing more than a refusal by a creditor (here, a bank), which both owes money (a deposit account) to a debtor and also is owed money by the debtor, to honor a debtor's payment request to the extent of the debtor's obligation.

The circuit courts of appeals are divided on this broader question of whether such a refusal is permitted before relief from the automatic stay is granted. The Third, Fourth and Eighth Circuits have held that it is not. See Small Business Admin. v. Reinhardt, 887 F.2d 165, 169 (8th Cir. 1989) (SBA not permitted to place administrative hold on payments due to the debtor under farm program); United States v. Reynolds, 764 F.2d 1004, 1007 (4th Cir. 1985) (IRS not permitted to place administrative hold on debtor's tax refund); United States v. Norton, 717 F.2d 767, 774 (3rd Cir. 1983) (same). These courts hold that an administrative hold is equivalent to the exercise of setoff rights and, therefore, violates the automatic stay of § 362(a)(7) of the Bankruptcy Code.

Alternatively, the administrative hold is viewed as an attempt to exercise control over property of the debtor, violative of § 362(a)(3).

The Eleventh Circuit, by contrast, does permit a "hold" of an account, at least for a brief period of time, to allow a creditor sufficient time to seek bankruptcy court approval to exercise its setoff rights. In In re Patterson, 967 F.2d 505 (11th Cir. 1992), a credit union "froze" a debtor's account upon receipt of notice that the debtor had commenced a case under Chapter 13 of the Bankruptcy Code. The credit union filed a proof of claim in the debtor's bankruptcy case, noting its security interest in the

debtor's account,[3] but otherwise took no action to obtain authorization to exercise its setoff rights until the debtor commenced a turnover proceeding and sought an injunction against the credit union. Patterson, 967 F.2d at 508.

The Patterson court held that the credit union, while validly concerned that the debtor might dissipate the collateral against which it sought to exercise its right of setoff, was required to act promptly to preserve the funds:

> The Credit Union's underlying concern is not frivolous, however. The Credit Union froze the Pattersons' accounts to avoid paying the Pattersons' checks, which would dissipate the Credit Union's collateral on its loan to the Pattersons. If the Credit Union's right to setoff were later determined valid, and if the funds in the account had been disbursed to payees, the Credit Union's right to setoff would indeed be an empty right. See In re Edgins, 36 B.R. 480, 484 (Bankr. 9th Cir. 1984) ("This will, all too often, be an attempt to lock the barn door after the horse has been stolen.").
>
> * * *
>
> Creditors in this position have an alternative remedy and need not freeze debtors' accounts. The creditor may file an ex parte motion pursuant to Sections 362(f) or 363(e) and accompany this motion with the funds from the debtors' account to be paid into the registry of the bankruptcy court.

Patterson, 967 F.2d at 510-11. In short, the Eleventh Circuit does allow a creditor to decline to honor checks drawn on a debtor's account, albeit briefly, to provide the creditor the ability to

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[3] As discussed, infra, at 26-27, the Bankruptcy Code treats a creditor holding a right of setoff as a secured creditor under § 506 of the Bankruptcy Code.

obtain court authority to exercise the right of setoff.[4]

The Fifth Circuit also has held that a creditor may refuse to honor a debtor's demand to turn over funds of the estate pending determination of such creditor's right of setoff, without incurring penalty or other sanction by the bankruptcy court. In In re Davis, 889 F.2d 658 (5th Cir. 1989), cert. denied sub nom., Campbell v. United States, 495 U.S. 933 (1990), the debtor moved under § 502(b) of the Bankruptcy Code to disallow a claim filed by a creditor, the Internal Revenue Service, on the ground that the IRS had refused to honor the debtor's demand to turn over a tax refund due to the debtor. The Fifth Circuit

[4] By contrast, the Fourth Circuit's approach permits no opportunity for a bank creditor to protect its setoff rights.

concluded that the IRS permissibly declined to pay the refund to the debtor pending resolution of the IRS's claim for penalty and interest, against which claim the IRS might have offset the refund due the Debtor. Id. at 663.

The resolution of the conflict between the Third, Fourth and Eighth Circuits, on the one hand, and the Eleventh and Fifth Circuits, on the other, will aid the lower courts immensely in administering provisions of the Bankruptcy Code governing a basic and important issue which arises repeatedly in bankruptcy cases. The Court need not tolerate division and uncertainty on a question so fundamental as whether a creditor must pay to the debtor monies which are the collateral of the creditor and otherwise are subject to the right of

setoff, before the creditor can obtain authorization from the bankruptcy court to exercise its right of setoff, thereby defeating any meaningful exercise of such right.

B. The District Courts And Bankruptcy Courts Are Also Divided On The Permissibility Of An Administrative Hold Or Freeze.

There is similar division among the lower courts as to whether a creditor may place an administrative hold or freeze on the funds of a debtor, in accordance with the creditor's rights under § 542 of the Bankruptcy Code, while the creditor seeks relief from the automatic stay. Four of six district courts, as well as the Bankruptcy Appellate Panel for the Ninth Circuit, have held that the use of an administrative hold or freeze is permissible. See In re Edgins, 36 B.R.

480, 485 (Bankr. 9th Cir. 1984); Air Atlanta, Inc. v. Nat'l Bank of Georgia, Inc., 81 B.R. 724, 726 (N.D. Ga. 1987); Rio v. Army Aviation Center Fed. Credit Union, 82 B.R. 138, 144 (M.D. Ala. 1986); Stann v. Mid. Am. Credit Union, 39 B.R. 246, 249 (D. Kan. 1984); Kenney's Franchise Corp. v. Cent. Fidelity Bank, N.A., 22 B.R. 747, 750 (W.D. Va. 1982).

Two district courts have held otherwise. Sousa v. Bank of Newport, 170 B.R. 492, 494 (D.R.I. 1994); Cusanno v. Fidelity Bank, 29 B.R. 810, 813 (E.D. Pa. 1983), vacated without opinion, 734 F.2d 3 (3rd Cir. 1984). See also In re New York City Shoes, Inc., 78 B.R. 426, 432 (Bankr. E.D. Pa. 1987) (freeze not permissible except under certain circumstances). Neither of the two decisions disallowing the freeze

discussed the impact of § 542(b) of the Bankruptcy Code on the issue.

Among bankruptcy courts, similar confusion exists, with a strong majority of courts holding that the implementation of an administrative hold or freeze is permissible. See In re Moreira, 173 B.R. 965, 967 (Bankr. D. Mass. 1994); In re Lough, 163 B.R. 586, 589 (Bankr. D. Idaho 1994); In re Pimental, 142 B.R. 26, 29 (Bankr. D.R.I. 1992); In re Briggs, 143 B.R. 438, 454 (Bankr. E.D. Mich. 1992); In re Air Atlanta, 74 B.R. 426, 427 (Bankr. N.D. Ga. 1987), aff'd, 81 B.R. 724 (N.D. Ga. 1987); In re Crispell, 73 B.R. 375, 380 (Bankr. E.D. Mo. 1987); In re R.H. Williams , 61 B.R. 567, 576 (Bankr. N.D. Tex. 1986); In re Hoffman, 51 B.R. 42, 46 (Bankr. W.D. Ark. 1985);

In re Carpenter, 14 B.R. 405, 408 (Bankr. M.D. Tenn. 1981).

A minority of bankruptcy courts have held that a freeze is not permitted. See In re Rio, 55 B.R. 814, 819 (Bankr. M.D. Ala. 1985), rev'd, 82 B.R. 138, 144 (M.D. Ala. 1986) (administrative hold is a freeze); In re LHG Resources, Inc., 34 B.R. 202, 204 (Bankr. W.D. Tex. 1983); In re Cusanno, 17 B.R. 879, 882 (Bankr. E.D. Pa. 1982), aff'd, 29 B.R. 810, (E.D. Pa. 1983), vacated without opinion, 734 F.2d 3 (3rd Cir. 1984) (freeze is setoff); In re Executive Assocs. Inc., 24 B.R. 171, 172 (Bankr. S.D. Tex. 1982) (freeze tantamount to setoff).

Even absent a conflict among the circuit courts of appeals on the narrow issue of the permissibility of an administrative hold while a creditor

seeks authorization to exercise its right of setoff, the Court may grant certiorari to rectify such widespread confusion among lower courts on an issue as important and basic as that presented here. See Dawson Chemical Co. v. Rohn & Haas, Co., 448 U.S. 176, 185 (1980) (certiorari granted to forestall possible conflict on issue of "prime importance" in patent law, even though no direct conflict existed among circuit courts of appeals). Countless bankruptcy cases involve a debtor having funds on deposit with a bank to which the debtor owes money. Whether the debtor may eliminate the bank's setoff rights and defeat its security interest by demanding the withdrawal of the deposit funds before the bank can obtain a bankruptcy court order authorizing a setoff presents a

fundamental issue concerning postbankruptcy petition relations between debtors and creditors. Resolving this issue now would serve to end repeated litigation and to create certainty with respect to one of the most basic aspects of debtor-creditor relations.

II. THE LOWER COURT'S RULING HAS SEVERAL SERIOUS NEGATIVE PRACTICAL IMPLICATIONS.

The result in Strumpf will negatively impact the manner in which debtors and bank creditors approach bankruptcy cases. From a creditor's perspective, Strumpf creates an enormous incentive on the part of a bank creditor to accomplish setoff before the prospective debtor files a bankruptcy petition. Under normal circumstances, a creditor's exercise of its right of setoff before the commencement of a

bankruptcy case is not subject to attack as a preference, or otherwise subject to any of the "avoidance" powers set forth in §§ 544, 545, 547, 548 and 550 of the Bankruptcy Code.

Moreover, once a bankruptcy case is filed, creditors will be compelled repeatedly to initiate ex parte litigation and to request emergency hearings. Indeed, the Fourth Circuit openly advocated that creditors file ex parte motions for relief from the stay if the creditor wishes to avoid losing its security (i.e., the debtor's funds on deposit with the bank), but does not wish to violate the automatic stay. See Strumpf, 37 F.3d at 159. Unfortunately, in the case of a request by the debtor to withdraw funds from a demand account "at the counter", even ex parte relief will

be of no avail. See In re Moreira, 173 B.R. at 968.

In the Eleventh Circuit, the Patterson opinion requires a bank which receives a draft on the debtor's checking account to seek emergency relief and pay the funds to the registry of the court by midnight of the date on which the debtor's check drawn on the account subject to setoff rights is presented. 967 F.2d at 511.

Absent the view adopted below, there would be absolutely no need for such emergency litigation. A motion for relief from the automatic stay must, under the express terms of § 362(e) of the Bankruptcy Code, be concluded within sixty days of its filing. If a bank creditor files such a motion concurrently with the institution of a freeze on the

debtor's account, a speedy resolution is required by the Bankruptcy Code. Denial of the writ of certiorari will condemn creditors to file "emergency" motions routinely, burdening the courts and hampering administration of the bankruptcy laws.

III. A BANK CREDITOR SHOULD NOT BE REQUIRED TO DISBURSE FUNDS FROM AN ACCOUNT OF ITS DEBTOR, PARTICULARLY WHERE THE CREDITOR MOVES PROMPTLY FOR AUTHORIZATION TO EXERCISE ITS SETOFF RIGHTS.

A. The Lower Court's Opinion Disturbs The Statutory Balance Between A Creditor's Right Of Setoff And A Debtor's Need To Preserve And Use Accounts.

Whether Citizens could properly defer Strumpf's demand to withdraw funds from his bank account pending determination of Citizens' right of setoff requires consideration of the interplay between no fewer than five different sections of the Bankruptcy

Code. The Fourth Circuit's opinion regrettably focused on only one, 11 U.S.C. § 362(a)(7). In doing so, the Court ignored the impact of §§ 363(a), 506(a), 553, and 542(b).

A creditor with a right of setoff under state law is treated as a secured creditor under the Bankruptcy Code pursuant to the express terms of § 506(a). Indeed, Citizens' security is treated as "cash collateral" pursuant to the terms of § 363(a).[5] Thus, "[A] bank stayed from setting off under § 362(a)(7) would be treated as the holder of a secured claim under § 506(a) to the

[5] Although the Fourth Circuit's opinion makes a passing reference to § 506(a) in a footnote, the Court did not examine in any way the consequences which flow from the fact that Citizens was a secured creditor of Strumpf and that Citizens' collateral is treated as cash collateral under the Bankruptcy Code. See Strumpf, 37 F.3d at 157 n.*.

extent of a deposit amount, and the deposit account is considered 'cash collateral' under § 363(a)." 2 James W. Moore & Lawrence P. King, Collier on Bankruptcy ¶ 363.02 (15th ed. 1994). In turn, the Bankruptcy Code provides that cash collateral cannot be used by a debtor unless the creditor secured by such collateral consents or unless the bankruptcy court first enters an order authorizing such use. See 11 U.S.C. § 363(c)(2).

In this case, Strumpf violated the express terms of § 363(c)(2) by withdrawing and using Citizens' cash collateral without Citizens' consent and without an order from the bankruptcy court authorizing such use. Indeed, the Fourth Circuit's opinion will no doubt be viewed by other debtors and their counsel

as a license to flout the rights of creditors with liens in cash collateral otherwise protected by the Bankruptcy Code.

In order to protect Citizens' rights as a secured creditor, the Bankruptcy Code expressly authorizes Citizens to withhold the funds due Strumpf pursuant to § 542(b) of the Code. That section requires that entities which owe a debt to the debtor that is matured, payable on demand or payable on order, must pay the debt to the trustee, "except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor." 11 U.S.C. § 542(b) (emphasis supplied).

The administrative hold placed on a debtor's account by a bank is nothing more than the mechanism by which the bank

communicates its decision to exercise its rights under § 542(b) to multiple branches, automated teller machines, and other actors with responsibility for administering bank accounts. Thus, an administrative hold precluding the debtor's access to funds in an account pending determination of a bank's right of setoff is "recognized and countenanced by 11 U.S.C. § 542(b). . . ." In re Edgins, 36 B.R. at 483.

The foregoing restrictions upon the exercise of the right of setoff by the creditor, on the one hand, and on the use by the debtor of such creditor's cash collateral, on the other, gives rise to a purposeful statutory equilibrium described by the Bankruptcy Appellate Panel for the Ninth Circuit as a "stalemate":

> This stalemate may be alleviated by either party initiating a number of alternative proceedings in the Bankruptcy Court.
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> * * *
>
> The creditor might bring an action for relief from the automatic stay for the purpose of asserting and exercising its security interest and right to setoff. The debtor might bring a motion for use of the security as cash collateral under 11 U.S.C. § 363. Any of these motions could be pursued by a motion and in a shortened time frame, given an emergency. The Bankruptcy Code does not specify which should be used nor whether the creditor or the debtor should initiate the action to break the statutory log jam.

In re Edgins, 36 B.R. at 483.[6]

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[6] A bank lender's inability to effectuate a setoff without violating the automatic stay has also been referred to as the "banker's dilemma." In re Bass Mechanical Contractors, Inc., 84 B.R. 1009, 1022 (Bankr. W.D. Ark. 1988).

Because the court below failed to consider several relevant statutes, the result reached was predictable:

> The Bankruptcy Code is a complex web often requiring the reconciliation of numerous sections to arrive at a determination of rights. The seemingly uncomplicated question or whether a bank owed money by its customer may temporarily freeze the customer's account upon learning of its bankruptcy cannot be answered adequately without considering the interplay of several Code provisions. When only Sections 553(a), recognizing the right of setoff, and 362(a)(7) applying the automatic stay to setoff, are considered, an erroneous conclusion is reached which prohibits the freezing of funds without court approval.

B. Weintraub & A. Resnick, Freezing the Debtor's Account: A Banker's Dilemma Under The Bankruptcy Code, 100 Banking L.J. 316, 324 (1983).

B. The Fourth Circuit's Opinion Reflects A Misunderstanding Of The Relationship Between The Depositor And The Bank.

The Fourth Circuit's failure to apply § 542(b) of the Bankruptcy Code[7] may be based upon a misapprehension of the nature of the debtor's "account" at Citizens. Although it is common for depositors and others to misperceive a "bank account" as the equivalent of a safe deposit box in which the depositor's funds are placed and held by the bank, the legal relationship between a depositor and the depository financial institution is that of creditor and debtor:

> It may be said generally that the relation of a bank and

[7] The Fourth Circuit's opinion mentions § 542(b) of the Bankruptcy Code in a footnote, but fails to recognize the significance of § 542(b) to this case. See Strumpf, 37 F.3d at 157 n.*.

> depositor is that of debtor and creditor; the money deposited is regarded as a loan to the bank by the depositor, with the right of the depositor to draw on it to the extent of the deposit.

Keller v. Fredericktown Sav. Inst., 66 A.2d 924, 925 (Md. 1949). See also Taylor v. Equitable Trust Co., 304 A.2d 838, 842 (Md. 1973); Gordon, Feinblatt, Rothman, Hoffberger & Hollander v. Gerhold, 608 A.2d 1194, 1201 (Md. App. 1992).

Under the terms of § 542(b) of the Bankruptcy Code, Citizens was not required to honor Strumpf's demand for payment of the "debt" owed by Citizens to Strumpf, pending determination of Citizens' setoff rights. The Fourth Circuit's holding to the contrary, eviscerating the protection afforded to Citizens by § 542(b) of the Bankruptcy

Code, appears to be a result of the Fourth Circuit's failure to recognize that Strumpf's deposit account at Citizens was a debt within the ambit of § 542(b). In essence, the holding below effectively denies to bank creditors the same right to withhold payment of funds subject to a claim of setoff which is available to virtually every other class of creditors.

C. The Court's Opinion Ignores Settled Law That The Right Of Setoff Must Be Respected, And Incorrectly Suggests That § 362(a)(7) Was Intended By Congress To Defeat The Right Of Setoff.

The Fourth Circuit's decision wrongly suggests that Congress intended a debtor to have the ability to defeat a creditor's right of setoff by moving quickly to withdraw funds or otherwise enforce the debtor's rights against the

creditor, before the creditor can obtain relief from the automatic stay. In the words of the Fourth Circuit: "While the banker's dilemma may allow a debtor to defeat a creditor's right of setoff, the clear and unambiguous language of § 362(a) produces this result". Strumpf, 37 F.3d at 159. As noted above, the Fourth Circuit reached an erroneous conclusion by focusing on only one of five different statutory provisions governing the right of setoff.

Moreover, the court's opinion disregards well-developed law concerning the right of setoff. As a threshold matter, a presumption exists in favor of the enforcement of the right of setoff. In re De Laurentiis Entertainment Group, Inc., 963 F.2d 1269, 1277 (9th Cir. 1992), cert. denied, ___ U.S. ___, 113 S.

Ct. 330, 121 L. Ed. 2d 249 (1992). Furthermore, there are but two circumstances under which a right of setoff may be denied to a creditor with mutual claims owed by and to a debtor. First, setoff has been denied where a creditor is overcollateralized or otherwise adequately protected. See, e.g., In re American Sunlake Ltd. Partnership, 109 B.R. 727, 737 (Bankr. W.D. Mich. 1989) (setoff not permitted where creditor adequately protected by equity cushion in real estate collateral). Second, a creditor may lose its setoff right when it has engaged in inequitable conduct. See, e.g., In re Cascade Roads, Inc., 34 F.3d 756, 762-66 (9th Cir. 1994) (setoff denied where creditor "stonewalled" debtor during receivable litigation).

This case does not fall within either of these two exceptions to the presumptive enforceability of the right of setoff. Citizens was protected by no other collateral of Strumpf, and Strumpf has made no showing that the Chapter 13 trustee had sufficient funds to pay Citizens. Nor is it suggested that Citizens committed misconduct of any kind which would justify denying its right of setoff. Indeed, the bankruptcy court below ultimately held that Citizens was entitled to exercise this right. Unfortunately, because the bankruptcy court had previously held that the administrative hold constituted a violation of the automatic stay and thus required Citizens to release all of the deposit funds, its ruling came too late,

leaving Citizens with a right of setoff but a hollow remedy.

The doctrine of setoff was grounded on the absurdity of making A pay B when B owes A. See Strumpf, 37 F.3d at 157 (citations omitted). Under the rule enunciated by the court below, that absurdity becomes reality, resulting in the virtual elimination of banks' and other creditors' time honored right of setoff.

D. The Court's Decision Incorrectly Equates A Setoff With A Bank's Temporary Refusal To Comply With A Debtor's Demand To Withdraw Funds.

Fundamental to the Fourth Circuit's decision was the conclusion that Citizens' refusal to honor the Strumpf's demand to withdraw funds was itself a setoff in violation of the automatic stay. This conclusion is contrary to

well-developed law governing precisely when a setoff has occurred.

Because the timing of a setoff often is crucial to establish priorities among competing creditors,[8] the law has developed a precise test to determine just when a setoff has actually occurred. In the leading case of Baker v. Nat'l City Bank of Cleveland, 511 F.2d 1016 (6th Cir. 1975), a bank attempted to argue that setoff of a bankrupt depositor's account had been accomplished before an order issued from the bankruptcy court staying the exercise of such right. The court disagreed:

> [T]he act of setoff is not complete until three steps have been taken: (i) the decision to exercise the right; (ii) some action which accomplished the setoff; and (iii) some record which evidences that the right of setoff has been recognized.

Baker, 511 F.2d at 1018. Accord United States v. Central Bank of Denver, 843 F.2d 1300, 1310 (10th Cir. 1988); In re Saugus Gen. Hosp., Inc., 698 F.2d 42, 47-48 (1st Cir. 1983). Indeed, the statutory "log jam" described in Edgins, supra, implicitly recognizes that there is a significant distinction between withholding payment to the debtor of funds which may be subject to the rights of setoff and the actual exercise of the setoff right. In re Carpenter, 14 B.R. 405, 407 (Bankr. M.D. Tenn. 1981).

In this case, Citizens did not debit Strumpf's account, or take any other steps to complete the setoff of Strumpf's

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[8] Priority among competing creditors with respect to depository accounts, including the depository institution itself as a creditor with right of setoff, is governed by § 4-303 of the Uniform Commercial Code. See Md. Comm. Law I Code Ann. § 4-303 (1992 Repl. vol.).

debt against the funds in Strumpf's account. Citizens clearly did not take all of the steps under Baker and its progeny necessary to constitute the full exercise of the right of setoff, nor did it intend to. Because Citizens did not accomplish the setoff against Strumpf's account, it did not violate § 362(a)(7) of the Bankruptcy Code.

CONCLUSION

Citizens respectfully requests that the Court grant this Petition for Writ of Certiorari.

Respectfully submitted,

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